No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,

Petitioners,

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE, STATE OF OHIO,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS, AS AMICUS CURIAE SUPPORTING RESPONDENT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes:

Miscellaneous:

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INTEREST OF THE AMICUS CURIAE

Founded in 1969, the National Conference of Insurance Legislators ("NCOIL") is a voluntary organization of legislators from 35 states who are involved in the development of public policy and the enactment of insurance-related legislation. One of NCOIL's purposes is stated succinctly in its Articles of Organization: to "reaffirm the traditional primacy of the states in the regulation of insurance."

With asset holdings of over $1.5 trillion, insurance companies are quasi-public financial institutions whose regulation is essential to the stability of domestic and foreign financial markets, as well as to the protection of policyholders. Edward B. Rappaport, Congressional Research Service, *CRS Report to Congress: Insurance Company Solvency* 1 (1989). With knowledge of these facts, Congress for nearly 200 years has entrusted the states with almost exclusive authority over insurance regulation. The states have responded systematically to that charge by enacting comprehensive legislation regulating insurance companies from licensure through dissolution. Each state has a department devoted exclusively to insurance regulation, including receivership administration.[1] The insurance departments of NCOIL's member states presently oversee the conservation, rehabilitation and liquidation of at least 329 insurance companies.[2] National Association of Insurance Commissioners, *Contact Person Report (Status of Multistate Insurance Company Departmental Supervisions, Conservatorships, Rehabilitations and Liquidations)* a-i (June 1992) (hereinafter "*Contact Person Report*").

[1] Some states (*e.g.*, Texas) administer insurance receiverships through independent contractors, while statutory or court-appointed receivers in other states administer them through private or quasi-public entities (*e.g.*, Illinois).

[2] There generally are three stages of insurance receivership: conservation (or supervision), rehabilitation and liquidation. In conservation, the receiver takes possession of an insurer's assets, business and affairs to conserve them for the benefit of creditors. *See, e.g.*, Illinois Insurance Code § 188.1, Ill. Rev. Stat. ch. 73, ¶ 800.1 (1991). Rehabilitation vests title to the company's assets in the receiver. *Id.* § 191, Ill. Rev. Stat. ch. 73, ¶ 803. Its purpose is the "preservation, whenever possible, of the business of an insurance company threatened with insolvency." *People ex rel. Schacht v. Main Ins. Co.*, 448 N.E.2d 950, 952 (Ill. App. Ct. 1983). Liquidation precludes the transaction of further business by the company and results in a final distribution of its assets. *See generally* Illinois Insurance Code §§ 187-221, Ill. Rev. Stat. ch. 73, ¶¶ 799-833.

Pursuant to Rule 37.2 of the Rules of this Court, NCOIL respectfully submits this brief as *amicus curiae* in support of Respondent. NCOIL has reviewed and adopts Respondent's arguments. In addition, its members have a substantial interest in the outcome of this case and can provide a unique perspective on the important issues presented. NCOIL believes that this brief will assist the Court in analyzing and resolving those issues. The parties have consented to the filing of this brief, and their written consents have been filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

Congress' endorsement of state insurance regulation has come into conflict with a federal statute which has nothing to do with insurance. Enacted in 1797, the federal insolvency statute, 31 U.S.C. § 3713 (the "Superpriority Statute"), grants the federal government first priority for payment of its claims from an insolvent debtor's assets, and imposes personal liability upon any debtor or trustee who pays another creditor first. Congress enacted this statute to secure an adequate revenue for the federal government. *United States v. Key*, 397 U.S. 322, 324 (1970). The new Republic represented a savior from the tyranny of English rule, and the Superpriority Statute was passed to ensure its prosperity. Since then, however, public opinion "as to the peculiar rights and preferences due to the sovereign" has changed, *Davis v. Pringle*, 268 U.S. 315, 318 (1925), and the Superpriority Statute no longer serves the purpose for which it was enacted. As Congress observed 15 years ago, "the time has [passed] when the sovereign . . .

is entitled to the first fruits of every insolvent estate." H.R. Rep. No. 595, 95th Cong., 1st Sess., pt. 1, at 194 (1977).

Consistent with this change, Congress has modified the Superpriority Statute to preclude its application in most receiverships. The Court already has held the Statute inapplicable in national bank receiverships, and Congress since has loosed the Statute's grip on thrifts. Likewise, Congress has eliminated the Statute's application to insurance receiverships. Three federal statutes contain terms that are inconsistent with the Superpriority Statute, and their language and legislative history reveal a purpose incongruous with its application to insurance receiverships. Both the language and legislative history of § 22 of the Bankruptcy Act of 1898, 11 U.S.C. § 22 (repealed 1978) (the "1898 Act"), and §§ 109(b)(2) and (d) of the Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 109(b)(2), (d) (the "1978 Code"), reveal that Congress intended to leave insurance receivership administration to the states. Likewise, the language and history of the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15 ("McCarran"), confirm that Congress meant for the states to regulate insurance companies from cradle to grave. Finally, the 1978 amendment to the Superpriority Statute, 31 U.S.C. § 3713(a)(2), reiterated Congress' intent to relegate the United States to a lower priority in the vast majority of receivership proceedings. When enacting each of these statutes, Congress knew the states had adopted legislation regulating all facets of insurance receiverships, including asset distribution. It thus would be absurd for Congress to authorize the states to determine in the public interest how the assets of an insolvent insurer should be distributed, only to undermine that determination by forcing payment of federal claims first.

NCOIL offers this brief because the United States' claim to a superpriority in insurance receiverships ignores Congress' expressed intent. The Sixth Circuit's decision upholding the State of Ohio's priority scheme sustains the purposes underlying the federal bankruptcy statutes and McCarran, and respects the states' authority to regulate insurance. In the face of Congress' consistent deference to state authority over all insurance matters, the United States' argument should be rejected and the Sixth Circuit's decision affirmed.

ARGUMENT

THE SUPERPRIORITY STATUTE DOES NOT APPLY TO INSURANCE RECEIVERSHIPS

The parties agree that the issue in this case is whether the Superpriority Statute applies to insurance receiverships, and the parameters for its resolution are well-established. The Statute will apply unless it has been repealed or modified either expressly or implicitly by a subsequent federal enactment. *Key*, 397 U.S. at 324 (1970). *Key* teaches that the Superpriority Statute is implicitly modified by legislation adopting a priority scheme if that legislation is logically inconsistent with the Statute, or if the legislation's language or legislative history reveals a purpose incongruous with the Statute's application. *Id.* at 326. Stated another way, "[e]xceptions to clearly delineated statutes will be implied only where essential to prevent 'absurd results' . . . ." *United States v. Rutherford*, 442 U.S. 544, 552 (1979) (citing *Helvering v. Hammel*, 311 U.S. 504, 510-11 (1941)).

This Court never has decided whether the 1898 Act, the 1978 Code and McCarran together have modified the Superpriority Statute. Other courts considering the superprior-

ity issue acknowledged that Congress has precluded insurance companies from being bankruptcy debtors, but otherwise focused their attention solely on McCarran.[3] In so doing, they overlooked the historical development of state insurance receivership law and thus the significance of Congress' consistent deference to that law. NCOIL believes it is vitally important that the Court not decide this case in an historical vacuum.

A. FEDERAL BANKRUPTCY LEGISLATION AND McCARRAN EVINCE CONGRESS' INTENT THAT THE SUPERPRIORITY STATUTE NOT APPLY TO INSURANCE RECEIVERSHIPS

1. The Bankruptcy Act of 1898

Until 1898, Congress was unable to enact a bankruptcy scheme that was more than a solution to temporary problems. Spencer L. Kimball, *History and Development of the Law of State Insurer Insolvency Proceedings: An Overview, in Law and Practice of Insurance Company Insolvency* 5 (David M. Spector, ed. 1986). The first three attempts to enact a permanent law in 1800, 1841 and 1867, all failed to produce the desired result—the 1800 and 1841 acts survived little more than a year, while the 1867 act

[3] *Fabe v. United States Dep't of the Treasury*, 939 F.2d 341, 347 (6th Cir. 1991), *cert. granted*, 112 S. Ct. 1934 (1992); *Idaho ex rel. Soward v. United States*, 858 F.2d 445, 450 (9th Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989); *Gordon v. United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir. 1987), *cert. denied*, 488 U.S. 954 (1988); *Lyons v. United States*, No. 4-91-10209, 1992 U.S. Dist. LEXIS 11714, at *5 (S.D. Iowa July 2, 1992); *Garcia v. Island Program Designer, Inc.* 791 F. Supp. 338, 341 (D. P.R. 1992); *see In re Union Indem. Ins. Co.*, 551 N.Y.S.2d 446 (Sup. Ct. 1990), *aff'd sub nom. Curiale v. United States*, 566 N.Y.S.2d 853 (App. Div. 1991), *petition for cert. filed*, 60 U.S.L.W. 3617 (U.S. Feb. 24, 1992) (No. 91-1347).

was repealed in 1874. *Id.* at 5-6. As a necessary consequence of Congress' inability to adopt an enduring bankruptcy scheme, the states enacted their own insurance receivership laws. *See, e.g., Carr v. Hamilton*, 129 U.S. 252 (1889) (state liquidation proceedings against life insurer instituted in 1879, after repeal of the 1867 Act). The first provisions for the receivership of insurance companies were adopted in 1828. *See* Rev. Stat. of N.Y., ch. XVIII, tit. II (1835). By 1898, California, Illinois and Texas[4] all had enacted legislation governing insurance company receiverships. *See* 1868 Cal. Stat. ch. CCC, §§ 7, 8; Ill. Rev. Stat. ch. 73, ¶¶ 84-92 (1874); Tex. Civ. Stat. Ann. tit. LVIII, ch. 2, art. 3050 (Batt's 1895) (incorporating insurance insolvency provisions from "An Act to create the Department of Insurance, Statistics and History," passed Aug. 21, 1876).

Meanwhile, Congress in 1864 enacted a receivership system for national banks. National Bank Act, ch. 106, 13 Stat. 99 (codified as amended at 12 U.S.C. § 21 *et seq.*). That act included a priority scheme which did not accord the federal government a superpriority. *See* 12 U.S.C. § 194. Section 194 established a ratable distribution plan which granted a first priority to the United States for the limited purpose of redeeming the debtor bank's circulating notes. In 1883, the Court held that this provision precluded application of the Superpriority Statute to bank receiverships:

[4] California, Illinois, New York and Texas historically have accounted for a comparatively large number of insurance receiverships. *See Contact Person Report, supra.* At present, these four states administer 142 of the 329 insurance receiverships under NCOIL members' control. *Id.*

> These provisions could not be carried out if the United States were entitled to priority in the payment of a demand not arising from advances to redeem the circulating notes. . . .
>
> These provisions must be deemed, therefore, to withdraw national banks, which have failed, from the class of insolvent persons out of whose estates demands of the United States are to be paid in preference to the claims of other creditors. The law of 1797 giving priority to the demands of the United States against insolvents, cannot be applied to demands against those institutions.

Cook County Nat'l Bank v. United States, 107 U.S. 445, 450-51 (1883).[5]

These federal and state receivership measures reflected the significant positions that banks and insurance companies always have occupied in the national economy. Like banks, insurance companies play a unique role in ensuring the public welfare and maintaining the public trust. Depositors put their money in banks to secure their financial positions, while policyholders buy insurance to guard against unexpected loss. Both depositors and policyholders expect their money to be available when they need it. House Subcommittee on Oversight and Investigations of

[5] The United States may argue, however, that the Superpriority Statute still applies to federal claims against *state* banks and savings associations, perhaps relying on *Bramwell v. United States Fidelity & Guar. Co.*, 269 U.S. 483 (1926), and *United States v. Oklahoma*, 261 U.S. 253 (1923). These early cases are inapposite, however, given the subsequent enactment of the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-33e (the "FDIA"), the Financial Improvement, Recovery, Reform and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (amending 12 U.S.C. § 1821), and the FDIC Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (amending 12 U.S.C. § 1821(c)). *See also* 12 C.F.R. § 360.2 (1992) (expressing federal policy that state law govern distribution priorities in bank receiverships).

the Committee on Energy and Commerce, *Failed Promises: Insurance Company Insolvencies* 1 (Comm. Print 1990). Accordingly, Congress has recognized that, while insolvency is a consequence of free market competition, it is unacceptable in "quasi-public" industries like banking and insurance.[6] *Id.*; *see also* Larry D. Carlson, *The Insurance Exemption from the Antitrust Laws*, 57 Tex. L. Rev. 1127, 1138-39 (1979). This congressional concern has produced pervasive regulation of those industries and justifies exception of state insurance priority schemes from the Superpriority Statute.

In 1898, Congress enacted a bankruptcy statute which remained in place (as amended) until 1978. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (codified as amended at 11 U.S.C. § 1 *et seq.*), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549. Marking a significant departure from the past, the 1898 Act contained a priority scheme which displaced the Superpriority Statute in bankruptcy liquidations. *United States v. Emory*, 314 U.S. 423, 428 (1941). As in the 1867 Act, *see, e.g.*, *Sawyer v. Hoag*, 84 U.S. 610 (1873) (bankruptcy petition filed against insurer in 1872) insurance companies and banks could be bankruptcy debtors. Thus, in 1898, Congress determined that the Statute would not apply in insurance liquidations.

In 1910, however, the Act was amended to preclude insurance companies and banks from being bankruptcy

[6] Contrary to the United States' assertions, Petitioner's Brief at 8, 18, policyholders do not "bear the risk" of their insurer's insolvency. *See generally* United States General Accounting Office, *Insurer Failures: Life/Health Insurer Insolvencies and Limitations of State Guaranty Funds* (1992) (describing how guaranty funds assume a failed insurer's policy obligations); United States General Accounting Office, *Insurer Failures: Property/Casualty Insurer Insolvencies and State Guaranty Funds* (1987) (same).

debtors. Three characteristics common to those institutions warranted the exclusion (both then and now): "(1) they are extensively regulated by well-organized departments of the states and of the United States; (2) they are subject to express statutory procedures for liquidation; and (3) the nature of their business is public or quasi-public and involves interests other than those of creditors." *First Am. Bank & Trust Co. v. George*, 540 F.2d 343, 349 (8th Cir. 1976), *cert. denied and appeal dismissed*, 429 U.S. 1011. By excepting banks and insurance companies from the 1898 Act, Congress acknowledged the adequacy of established state receivership machinery. *Woolsey v. Security Trust Co.*, 74 F.2d 334, 337 (5th Cir. 1934). As the Second Circuit observed: "The most natural inference is that Congress meant to leave to local winding up statutes the liquidation of such companies; that, since the state commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise." *In re Union Guar. & Mortgage Co.*, 75 F.2d 984 (2d Cir. 1935), *cert. denied*, 296 U.S. 594.

By endorsing state administration of insurance receiverships, Congress perforce agreed that the states should continue ordering priorities of asset distribution. Priority schemes always had been an integral part of receivership administration, particularly liquidations; the State of Illinois, for example, enacted its first priority distribution statute for insurance receiverships in 1874. *See* Act of Feb. 17, 1874, Ill. Rev. Stat. ch. 73, ¶ 89 (repealed 1925). Surely Congress did not entrust the liquidation of insolvent insurance companies to such a well-developed body of state law without the concomitant power to determine the priority of asset distribution. By amending the 1898 Act to except insurance companies, Congress acknowledged that the states had enacted sufficient legislation governing insurance receivership administration, and that

they should continue to do so without federal interruption. Congress confirmed this intent in 1945.

2. The McCarran-Ferguson Act of 1945

Congress' 1945 enactment of the McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified at 15 U.S.C. §§ 1011-15), confirmed the states' authority to regulate all aspects of the business of insurance. By that time, most states had adopted insurance receivership schemes that were modeled on the New York statute, N.Y. Ins. Law ch. 30, §§ 400-28 (Consol. 1932), and the Uniform Insurers Liquidation Act, 13 U.L.A. 321 *et seq.* (1939) (the "UILA"). *Cf.* 1935 Cal. Stat. ch. 291, § 1010 *et seq.*; Ill. Rev. Stat. ch. 73, ¶¶ 799-833 (1935); Tex. Rev. Civ. Stat. Ann. tit. 78, art. 5068c (1939); *see also* 1936 National Ass'n of Ins. Comm'rs Proc. 30-32 ("An act relating to the rehabilitation, reorganization or liquidation of insurers doing business in more than one state"). The New York statute contained a priority scheme consistent with settled common law principles: administration expenses were paid first, N.Y. Ins. Law ch. 30, § 419, followed by wage claims, *id.*, and then all other claims according to priorities the receivership court directed. *Id.* § 426. Equity interest claims were paid last. It was to predecessors of those receivership schemes that Congress deferred in 1910 when it excepted insurance companies from federal bankruptcy proceedings, and those schemes were part of the "*status quo*" that the United States concedes McCarran was intended to preserve. *See* Petitioner's Brief at 23. Congress' sweeping endorsement of state regulation in McCarran thus confirmed its intent that the states continue administering insurance receiverships.[7] Indeed, the

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[7] This Court's decision in *United States v. Knott*, 298 U.S. 544 (1936), does not compel a different result. *Knott* was decided *before* McCarran and § 109 of the 1978 Code were enacted, and before

(Footnote continued on following page)

Court quickly upheld the statute against a challenge that Congress had no power to consent to such legislation.[8] *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 438 (1946).

Consistent with its endorsement of state receivership legislation, Congress determined that the Superpriority Statute would not apply to insurance receiverships. This intent is expressed in the language of McCarran. Section 2 provides that no act of Congress may invalidate, impair or supersede a state regulatory law unless that act specifically relates to the business of insurance. 15 U.S.C. § 1012(b). The antitrust, labor and merchant marine laws identified in §§ 3 and 4, *Id.* §§ 1013, 1014, are the only exceptions to this rule. Conspicuously absent is any reference to the Superpriority Statute. Senator O'Mahoney, one of the Senate conferees and a floor manager of the legislation (91 Cong. Rec. 1208 (1945)), explained why: "[A] good faith attempt was made to specify *every single law* which had an application, or might have an application, to insurance." 91 Cong. Rec. 483 (1945) (emphasis added). Thus, McCarran's "coordinated exercise of federal and state authority," *Prudential*, 328 U.S. at 438, preserved

[7] *continued*

the Superpriority Statute was amended. *See infra* part 3. The decision addressed whether securities deposited in Florida by an insolvent New Jersey insurance company constituted a perfected lien and thus should be used first to pay the claims of Florida creditors before the federal government's claim. This Court simply was not asked whether the Superpriority Statute applied in insurance receiverships.

[8] It follows that McCarran's approval of state receivership statutes does not violate the constitutional mandate in Article I, Section 8, Clause 4 that bankruptcy laws be uniform throughout the United States; only *federal* bankruptcy laws are so limited. *See Prudential*, 328 U.S. at 438 (rejecting argument that McCarran's sanction of state tax laws violated uniformity requirements of Article I, Section 8, Clause 1, and holding that the limitation applies only when federal taxing power "is exerted without reference to any state action").

state administration of insurance receiverships by suspending the application of federal laws (like the Superpriority Statute) that do not relate specifically to the business of insurance.

Following its adoption, the states considered McCarran a congressional mandate to enact legislation governing all aspects of the business of insurance. Accordingly, their chief insurance regulators joined forces through the National Association of Insurance Commissioners ("NAIC") and the Conference on Uniform State Laws to enact model or uniform legislation "to cover regulation of insurance growing out of the Supreme Court decision [in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944)] and [McCarran]." 1945 National Ass'n of Ins. Comm'rs Proc. 263. In particular, they focused their attention on receivership law: "The uniform liquidation act has been adopted by many states, and Departments whose states do not have a good liquidation act, might well review the act . . . ." *Id.* at 264. Before McCarran was enacted, seven states had adopted the UILA; another 26 states ultimately joined their ranks. 13 U.L.A. at 321.

In 1967, the states began re-ordering the priority of receivership claims to protect policyholders. That year, the State of Wisconsin enacted a new insurance receivership statute which created a separate creditor class for policyholders above general creditors, and relegated federal claims to a lower priority. Wis. Stat. Ann. § 645.68 (West 1980). The Wisconsin legislature regarded preferred treatment of policyholder claims as essential to protect vulnerable consumers who purchased insurance for the sole purpose of avoiding loss:

> [The policyholder] class contains the claims central to the social role of insurance. The typical policy is not an ordinary mercantile contract, but one of great

> public importance. In the usual case, if a policyholder loses a premium, he is not seriously harmed, but if a loss goes unpaid, or even unpaid in substantial measure, great harm is likely to be done.

Wis. Stat. Ann. § 645.68(3) cmt. at 510.

The commentary to the Wisconsin statute reveals the legislature acknowledged a potential conflict with the Superpriority Statute, but determined that § 22 of the 1898 Act and McCarran had resolved any conflict in favor of state legislation:

> Congress exempted insurance companies from the operation of the [1898] Act in recognition of the fact that they are subject to a complete system of state regulation, which extends to the rules governing insolvency. . . . [I]t is clear that insurance regulation in general, and this chapter in particular, *including the section on priorities*, is part and parcel of the regulatory structure, and has a real impact on the ongoing insurance operation. It follows, therefore, that the [Superpriority Statute] cannot "invalidate, impair, or supersede" the priority system of this section.

Wis. Stat. Ann. § 645.68(5) cmt. at 513 (emphasis added). Since then, courts repeatedly have recognized the states' right to establish priority schemes and administer insurance receiverships.[9] *See, e.g., Baldwin-United Corp. v. Garner*, 678 S.W.2d 754, 758 (Ark. 1984), *cert. denied*, 471 U.S. 1111 (1985). ("If any meaning is to be given to the congressional exclusion of insurance companies from the [1898 Act] and the mandate of the McCarran-Ferguson Act, it must be that the determination of rights among

[9] The United States' suggestion (Petitioner's Brief at 24 n. 11) that all state courts have held or assumed the Superpriority Statute applies in insurance receiverships post-McCarran, therefore, is in error.

an insurance company's creditors must be left to state proceedings"); *see also Grode v. Mutual Fire, Marine and Inland Ins. Co.*, 572 A.2d 798, 808 (Pa. Commw. 1990), *aff'd sub nom. Foster v. Mutual Fire, Marine and Inland Ins. Co.*, No. J-108-1990 (Pa. Aug. 21, 1992) (stating without deciding that "McCarran-Ferguson would appear to preclude the application of the [Superpriority Statute]"); *Lyons* and *Garcia*, *supra*, n. 3.

3. The Bankruptcy Reform Act of 1978

After extensive examination of the federal bankruptcy system, Congress in 1978 improved the 1898 Act with a "modernized" bankruptcy code. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. § 101 *et seq.*). Re-codifying § 22 of the 1898 Act as §§ 109(b)(2) and (d) of the 1978 Code, Congress reiterated its intent to consign the conservation/supervision, rehabilitation and liquidation of insurance companies to established state law: "Banking institutions and insurance companies engaged in business in this country are excluded from liquidation under the bankruptcy laws because they are bodies for which alternate provision is made for their liquidation under various State or Federal regulatory laws." S. Rep. No. 989, 95th Cong., 2d Sess. 31 (1978). Here is the unmistakable expression of congressional intent that state law govern insurance receiverships.[10] By entrusting receivership administration

[10] Congress certainly did not have the Superpriority Statute in mind when it referred to "Federal" regulatory laws. As demonstrated above, both § 22 of 1898 Act and case law construing that provision, *see, e.g., Woolsey*, 74 F.2d at 337, indicate that the "alternate provision" to which Congress referred was the well-developed body of state insurance receivership law and the federal laws regulating banks, *e.g.*, the National Bank Act and the FDIA.

to the states, Congress expressed its intent that state law govern priorities of distribution. Today, in all but 13 states, the federal government's claims are relegated to a position equal to or lower than policyholders, depending on the nature of the claim; in only four states (Arizona, California, Florida and Virginia) are federal claims accorded absolute priority. *See* Appendix; *see also* Wis. Stat. Ann. § 645.68 cmt. at 508 ("claims that are socially more important need to be paid ahead of those that are less important").

Congress did not limit the expression of its intent to the reforms made in the 1978 Code. Recognizing that the United States no longer needed the protection of the Superpriority Statute in the vast majority of receivership proceedings, Congress expressly amended the statute in 1978 to exempt all bankruptcy proceedings from its reach. *See* Act of Nov. 6, 1978, Pub. L. No. 95-598, § 322(a), 92 Stat. 2678 (codified at 31 U.S.C. § 3713(a)(2)) ("This subsection does not apply to a case under title 11."). The rationale for the amendment was straightforward:

> Equality of distribution is the rule in bankruptcy, and supported by long years of strong bankruptcy policy. . . . There have been steady calls for the elimination or reduction of the non-tax priority of the United States, especially in bankruptcy cases, *where the priority is exercised at the expense of other creditors of the bankrupt.*

H.R. Rep. No. 595, 95th Cong., 1st Sess. 285 (1977) (emphasis added).

The United States' argument that the Superpriority Statute trumps state insurance receivership laws by virtue of the Supremacy Clause, U.S. Const. art. VI, cl. 2, erroneously assumes that the Statute has "survived to this day essentially unchanged." Petitioner's Brief at 6, 10 (quoting

United States v. Moore, 423 U.S. 77, 80 (1975)). In fact, Congress in 1978 eviscerated the Superpriority Statute when it excepted the vast majority of receivership proceedings from the Statute's reach.[11] *See* 31 U.S.C. § 3713(a)(2). Thus, having relinquished its superpriority claim, the United States cannot seriously contend that the Statute is "fundamental" (Petitioner's Brief at 11) to the national government's success.

The fact that the Superpriority Statute was not amended to exclude bank and insurance receiverships is of no moment. By the 1978 amendment, Congress simply put its federal bankruptcy house in order. Distributions in federal liquidation proceedings had fallen outside the statute's reach for 80 years, *see Emory*, 314 U.S. at 428; the amendment merely extended that protection to federal reorganization proceedings, *see Key*, 397 U.S. at 326 (Superpriority Statute imposed upon bankruptcy reorganizations under 1898 Act). There was no need to address the well-recognized banking and insurance exceptions already embodied in the 1978 Code.[12]

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[11] The significance of the amendment is easily demonstrated. During 1980, 331,098 bankruptcy cases were filed, and 292,929 remained pending at the end of the year. Administrative Office of the United States Courts, *Federal Judicial Workload Statistics* (Dec. 31, 1990) 11. During 1990, those numbers had grown to 782,960 and 1,033,230, respectively. *Id.* Among the debtors included in those statistics are Texaco, Pan Am, Johns-Manville and Continental Airlines. In contrast, from 1975 through 1990, only 176 life/health insurers were declared insolvent and placed into receivership. *Life/Health Insurer Failures, supra*, at 3. Between 1969 and 1990, 372 property/casualty insurers suffered the same fate. A.M. Best Co., Inc., *Best's Insolvency Study: Property/Casualty Insurers 1969-90* 2 (June 1991).

[12] Congress had provided for distributions in bank receiverships under the National Bank Act, 12 U.S.C. § 194, and this Court had recognized the modification of the Statute wrought by that Act.

(Footnote continued on following page)

B. CONGRESS HAS MODIFIED THE SUPERPRIORITY STATUTE

As demonstrated above, § 22 of the 1898 Act, §§ 109(b)(2) and (d) of the 1978 Code, and McCarran are logically inconsistent with the terms of the Superpriority Statute. Moreover, their language and legislative history reveal a congressional purpose incongruous with the Statute. As a result, the federal bankruptcy laws and McCarran have implicitly modified the Superpriority Statute and excepted insurance receiverships from its application.

The logical inconsistency between the federal bankruptcy laws and McCarran, and the Superpriority Statute cannot be reconciled. The Statute is a deceptively simple act, suggesting that it applies to all non-bankruptcy proceedings. However, it squarely conflicts with McCarran, which provides that only federal laws specifically relating to insurance may trump state laws, and identifies only limited exceptions to this rule. The Superpriority Statute does not mention insurance and is not among those exceptions. A more patent inconsistency between statutes is difficult to imagine. Moreover, by §§ 22 of the 1898 Act and 109(b)(2) and (d) of the 1978 Code, Congress manifested its intent that state law govern insurance receivership administration. When those sections were enacted, states already had adopted receivership laws containing priority distribution schemes

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[12] *continued*

Cook County Nat'l Bank, supra. In 1950, Congress expressly adopted state priority schemes for the liquidation of insured state banks, *see* 12 U.S.C. § 1821(e), and in 1989 and 1991 extended the reach of this provision to include insured state savings associations, *see* 12 U.S.C. §§ 1813, 1821. Similarly, Congress enacted McCarran for the express purpose of precluding application of the Superpriority Statute and all other federal acts not related to insurance. 15 U.S.C. § 1012(b).

which did not accord a superpriority to federal claims. Congress thus placed its imprimatur upon state receivership laws, including priority schemes that are inconsistent with the Superpriority Statute.

Applying the Statute to insurance receiverships also is incongruous with longstanding federal policies favoring state supervision and liquidation of insolvent insurers, protection of policyholders, and maintenance of public confidence in the insurance industry. Since 1910, federal bankruptcy laws have made insurance receivership regulation the sole province of the states. In response to this congressional mandate, the states have shouldered the responsibility for regulating all aspects of those receiverships. In a lawful exercise of their police power, most states have enacted priority schemes which prefer policyholder claims over those of general creditors and the federal government, for good reason. Unlike most individual policyholders, the United States is a sophisticated creditor and insurance consumer, able to protect itself adequately against unexpected loss. Consequently, requiring the government to underwrite policyholder loss serves a significant social interest:

> [T]hat social interest is attested to by the staggering amount spent by the federal government, and even by state and local governments, on various insurance-like schemes to deal with a great variety of problems, as often as not after the fact. Medicare and Medicaid should suffice to illustrate the point . . . .

Kimball, *supra*, at 33. State schemes elevating policyholder claims over those of general creditors and the United States protect the innocent consumer from the ruinous consequences that may follow when he or she suffers a loss and limited funds are available for compen-

sation. The resulting benefits to policyholders dwarf any residual gains derived from an absolute federal priority.

Imposing the Superpriority Statute upon insurance receiverships contravenes Congress' intent to secure for policyholders the full measure of state protection. The states cannot protect policyholders if the United States is allowed to diminish or even exhaust estate assets by invoking the Statute. Surely, after consenting to state administration of receiverships, Congress could not have intended to trump state priority schemes,[13] diminish policyholder protection, and paralyze receivers with the threat of personal liability for paying anyone else first. While equal treatment of unsecured creditors is the rule in federal bankruptcies, all states have determined that this principle cannot be applied in insurance receiverships, where protection of policyholders is the paramount concern. Effecting Congress' intent to protect the most vulnerable creditors of public or quasi-public entities also requires that the Superpriority Statute not apply to receiverships specifically designed to provide that protection.

[13] This incongruity is all the more acute where the payment of federal claims pursuant to the Superpriority Statute depletes estate assets before policyholders are paid. As such, the Statute not only trumps state priority schemes, but may render them meaningless.

CONCLUSION

Congress has declared repeatedly that experienced and knowledgeable state legislatures and officials are best placed to balance competing rights of creditors in insurance receiverships, and has entrusted the states with that responsibility. Applying the Superpriority Statute to insurance receiverships creates an unacceptable paradox: the Statute does not apply where creditors do not need extra protection, but does apply to deny protection to those who need it most of all. In other words, those who purchased insurance specifically to avoid risk of loss are less protected than creditors of bankrupts who knowingly assumed that risk in commercial ventures. Acknowledging the Statute's modification avoids this paradox and is most consonant with Congress' consistently expressed intent that the administration of insurance receiverships is the *states'* responsibility. Superimposing a federal superpriority upon established, sophisticated state receivership systems can only throw their administration into unnecessary turmoil.

Therefore, the Sixth Circuit's decision should be affirmed.

Respectfully submitted,

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APPENDIX

State	Priority Scheme	Private Policyholder Claims[1]	Federal Government Policyholder Claims	Other Federal Government Claims
Alabama	Alabama Code §27-32-37	preferred over general creditors	NSP[2]	recorded tax liens preferred over policyholders
Alaska	Alaska Stat. §21.78.260	(3)	(3)	(5), (8)
Arizona	Ariz. Rev. Stat. Ann. §20-629	preferred over general creditors	absolute priority	absolute priority
Arkansas	Ark. Code Ann. §23-68-126	(3)	NSP	(5), (8)
California	Cal. Ins. Code §1033	(5)	(4)	(4)
Colorado	Colo. Rev. Stat. §10-3-507	(c)	NSP	(b) for taxes and debts secured by perfected liens[3]
Connecticut	Conn. Gen. Stat. §38a-944	(3)	(3)	(6), (8)
Delaware	Del. Code. Ann. tit. 18, §5918	preferred over general creditors	NSP	taxes preferred over policyholder claims

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
D.C.	D.C. Code Ann. §35-1508	(4)	NSP	(3) for taxes secured by perfected liens; (5) for other claims
Florida	Fla. Stat. Ann. §631.271	(4)	(2)	(2)
Georgia	Ga. Code Ann. §33-37-41	(3)	(3)	(5), (8)
Hawaii	Hawaii Rev. Stat. §431: 15-332	(4)	NSP	(6), (8)
Idaho	Idaho Code §41-3342	(3)	NSP	(5), (8)
Illinois	Ill. Rev. Stat. ch. 73, ¶817(1)	(c)	(c)	(b) for taxes and debts secured by perfected liens; (d) for other claims
Indiana	Ind. Code §27-9-3-40	(3)	NSP	(5), (8)
Iowa	Iowa Code Ann. §507C.42	(3)	(3)	(5), (8)

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
Kansas	1991 Kan. Sess. Laws ch. 125, §37	(3)	(3)	(5), (8)
Kentucky	Ky. Rev. Stat. Ann. §304.33-430	(3)	(3)	(4), (7)
Louisiana	La. Rev. Stat. Ann. §22:746	(3)	NSP	NSP
Maine	Me. Rev. Stat. Ann. tit. 24-A, §4379	(3)	(3)	(5), (8)
Maryland	Md. Code Ann., Ins. §§158, 158A	preferred over general creditors	NSP	taxes preferred over policyholder claims
Massachusetts	Mass. Gen. L. ch. 175, §180F	(4)	NSP	(3) for taxes and debts secured by perfected liens
Michigan	Mich. Comp. Laws §500.8142	(3)	NSP	(5), (8)
Minnesota	Minn. Stat. Ann. §60B.44	(4)	(4)	(3) for taxes required to be withheld from wages; (6), (9)

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
Mississippi	Miss. Code Ann. §83-24-83	(3)	(3)	(5), (8)
Missouri	Mo. Ann. Stat. §375.1218	(2)	(2)	(5), (8)
Montana	Mont. Code Ann. §33-2-1371	(3)	NSP	(5), (8)
Nebraska	Neb. Rev. Stat. §44-4842	(3)	NSP	(5), (8)
Nevada	Nev. Rev. Stat. Ann. §696B.420	(3)	(3)	(5), (8)
New Hampshire	N.H. Rev. Stat. Ann. §402-C: 44	III	III	IV, VII
New Jersey	N.J. Stat. Ann. §17:30C-26c	(4)	NSP	(3) for taxes and debts secured by perfected liens
New Mexico	N.M. Stat. Ann. §59A-41-44	C	C	E, K[4]
New York	N.Y. Ins. Law §§7426, 7435[5]	(4)	NSP	(5), (8)

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
North Carolina	N.C. Gen. Stat. §58-30-220	(3), (5)	NSP	NSP
North Dakota	N.D. Cent. Code §26.1-06.1-41	(3)	(3)	(5), (8)
Ohio	Ohio Rev. Code Ann. §3903.42	3	NSP	(5), (8)
Oklahoma	Okla. Stat. Ann. tit. 36, §1927	3	NSP	NSP
Oregon	Or. Rev. Stat. §734.360	(4)	NSP	(3) for taxes
Pennsylvania	Pa. Stat. Ann. tit. 40, §221.44	(c)	NSP	(e), (g)
Puerto Rico	P.R. Laws Ann. tit. 26, §4012	preferred over general creditors	NSP	NSP
Rhode Island	R.I. Gen. Laws §27-14-22	(d)	NSP	(c) for taxes
South Carolina	S.C. Code Ann. §38-27-610	(3)	(3)	(5), (9)

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
South Dakota	S.D. Codified Laws Ann. §58-29B-124	3	NSP	5, 8
Tennessee	Tenn. Code Ann. §59-9-330	3	3	5, 8
Texas	Tex. Ins. Code Ann. §8	2	2	3
Utah	Utah Code Ann. §31A-27-335	(3)	(3)	(5), (6)
Vermont	Vermont Stat. Ann. tit. 8, §7081	(3)	(3)	(5), (8)
Virgin Islands	V.I. Code Ann. tit. 22, §1277	3	NSP	5, 8
Virginia	Va. Code Ann. §§38.2-1509, 1514	(iv)	(iii)	(iii) for taxes and other debts entitled to priority
Washington	Wash. Rev. Code Ann. §48.31.280	(d)	NSP	(c) for taxes

State	Priority Scheme	Private Policyholder Claims	Federal Government Policyholder Claims	Other Federal Government Claims
West Virginia	W. Va. Code §33-10-19a	III	III	V, VIII
Wisconsin	Wis. Stat. Ann. §645.68	(3)	(3)	(5), (8)
Wyoming	Wyo. Stat. §26-28-125	(iii)	(iii)	(iv)

1 Under the Wisconsin statute, claims were organized by priority. Most states rank claims as follows: (1) administrative expenses; (2) wages; (3) policyholders; (4) general creditors; (5) government claims; (6)-(8) subordinated claims and equity. The numbers and letters used in this table reflect the statutory class assigned to the claims identified in each column.

2 "NSP" appears where the relevant statute does not contain a specific provison for the claims in question.

3 In each instance where a reference to perfected liens appears in this table, the liens must have been perfected prior to commencement of the receivership proceedings.

4 Paragraph E contains a reference to Paragraph K; however, there is no such Paragraph.

5 Section 7435 relates only to distributions of assets of life insurers in receivership.